The Trouble with Shareholder Value *Ideology*: New Insights from Economics and Corporate Law

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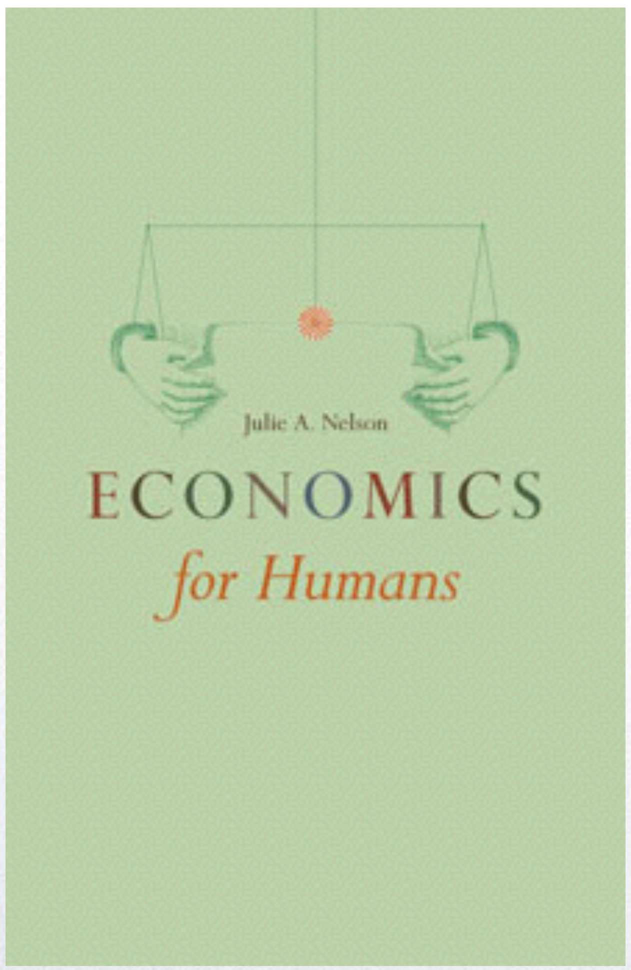
Milan, 3 October 2014

Outline

1. The Economist's perspective:
   Julie Nelson's ***Economics for Humans*** (2006)
   - *What if the Economy is not a machine?*
2. The Corporate Law perspective:
   Lynn Stout's ***The Shareholder Value Myth*** (2012)
   - *Shareholder Value Primacy gets Corporate Law (and corporate economics) wrong!*
3. Considerations from a Stakeholder Theory perspective
   - Common ideas?
   - Open questions

1. The perspective of the Economist: Julie Nelson (2006)



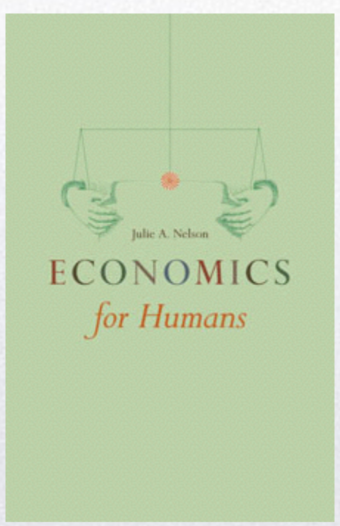
Julie Nelson is Department Chair and Professor of Economics, College of Liberal Arts, University of Massachusetts Boston

"The fact that an organisation is run as a "for profit" in no way requires, either by law or economic "mechanism", that it must have profit as its *sole* goal"
(Nelson, 2006: 114)

The Problem:
The *Economy-as-a-machine* metaphor

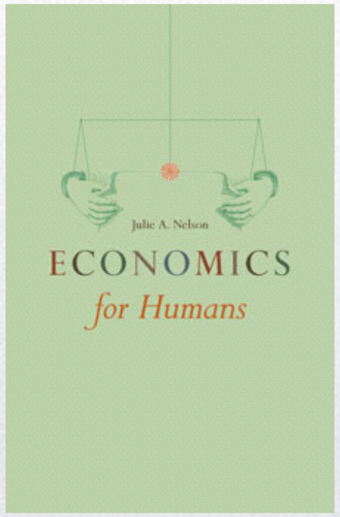
"The capitalist economy can usefully be viewed as a machine whose primary product is economic growth"

- People are driven by *self-interest*
- Good outcomes arise *automatically* ("invisible hand")
- Markets are *impersonal*
- *Amoral* laws & *inexorable forces*

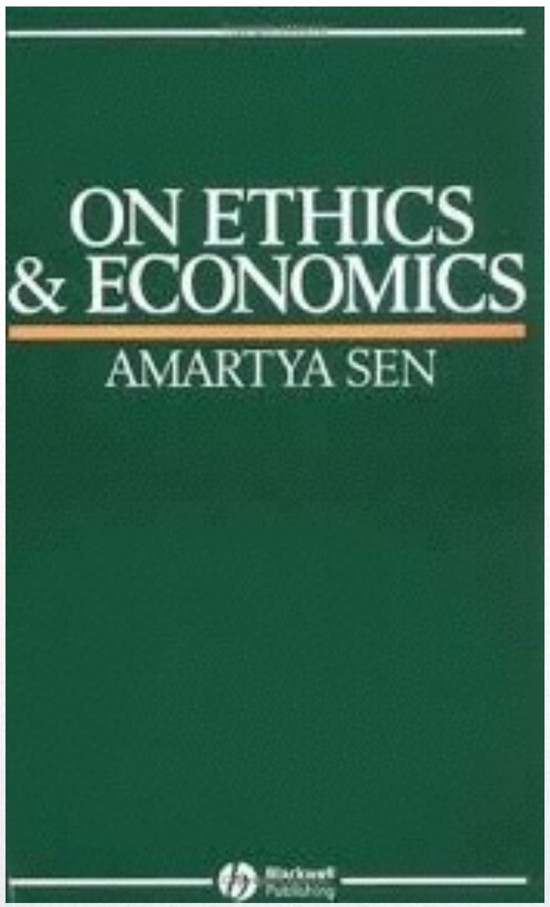


What if the Economy is not a Machine?

- “The idea that economic systems are inanimate machines operating according to amoral laws is a ***belief***, not a fact”
- “This belief has ***harmful effects***—for life on the planet, for human society, and for you in particular” (Nelson, 2006: 4)



Amartya Sen on the ‘engineering’ approach to economics (1987)



Amartya Sen is Thomas W. Lamont University Professor, and Professor of Economics and Philosophy, at Harvard University.

He won the Nobel Prize in Economic Sciences (1998)

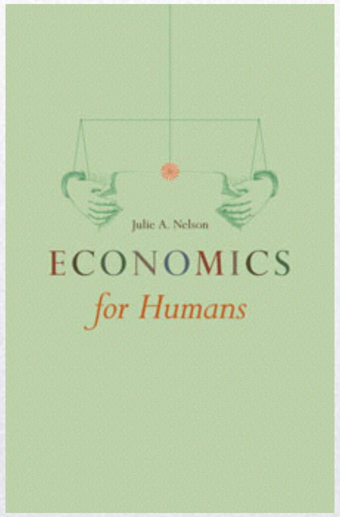
I would argue that the nature of modern economics has been substantially impoverished by the distance that has grown between economics and ethics”

(Sen, On Ethics and Economics, 1987: 7)

…economics can be made more productive by paying greater and more explicit attention to the ethical considerations that shape human behaviour and judgment” (1987: 9)

The Economy-as-a-Machine: A damaging metaphor

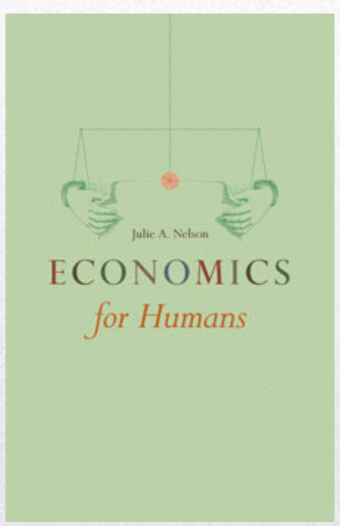
- *Naive and irresponsible* **probusiness policies**
  - probusiness advocates do not think corporations *should* include social responsibility in their purpose
- *Naive and impractical* **antimarket alternatives**
  - antimarket critics do not think that corporation *could* ever be socially responsible



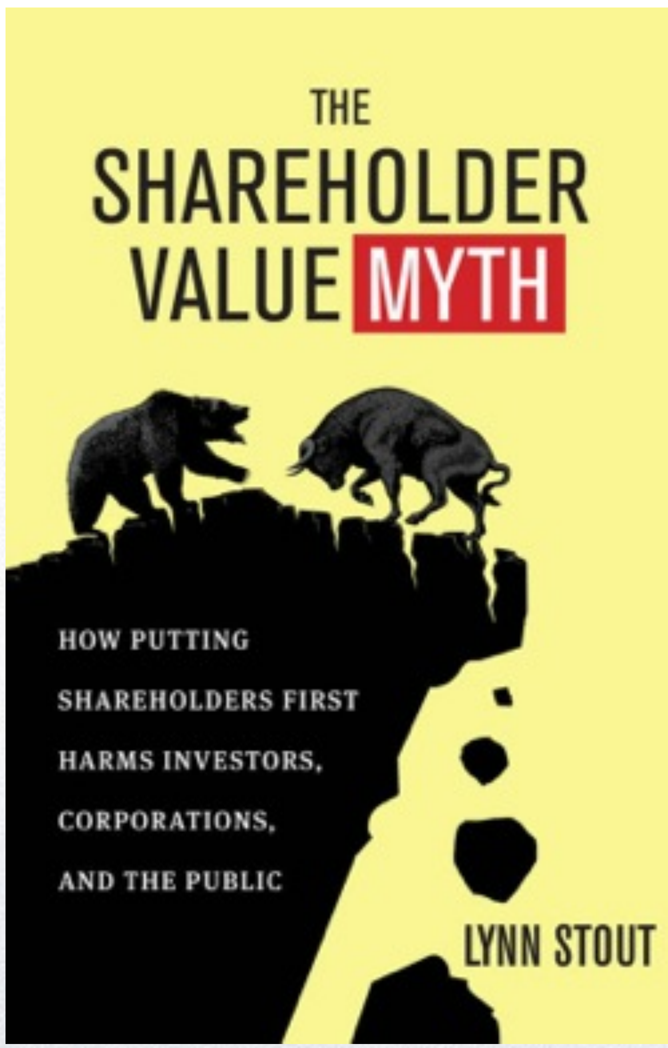
- *It the machine metaphor that tell that ethics is irrelevant to economics and that "economic value" are limited to self-interest*
- *Dialogue is blocked, paradoxically, because both groups assume the economy-as-a-machine metaphor […] the firm is driven to maximize profits by inextricable forces* (Nelson, 2006: 54 & 57)

An alternative: metaphor: The Beating Heart

- A *living*, vital organ for the ***body***
- *Moving flows* of lifeblood throughout the body (like the economy is made by the circulation of goods and services)
- A living entity, can be *healthy* and strong, or become weak, *clogged* and degenerate (e.g. unhealthy concentrations of goods and services may pose a risk of heart failure)
- *Adapts* and coevolves with ***culture*** and ***institutions***
- The centre of ***love*** (economy of care)
- A symbol of ***courage*** (we are not clogs in a machine…)
- **“Economy of care” and “business ethics” are not *options*, but requirements**



2. The Corporate Law perspective: Lynn Stout (2012)



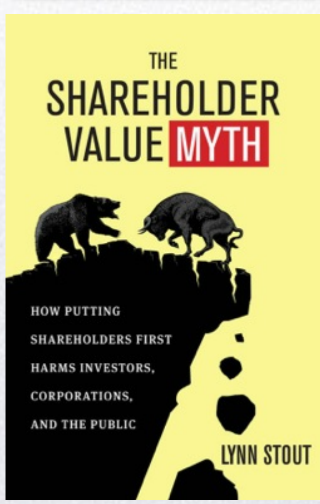
Lynn Stout is Distinguished Professor of Corporate & Business Law, Cornell University Law School

"'Maximize shareholder value' is an incoherent and counterproductive business objective"
(Stout, 2012: vi.)

How Shareholder Primacy Gets Corporate Law Wrong: The flaws of the Principal-Agent model

The Principal-Agent Model

1. Shareholders ***own*** corporations
2. Shareholders are the ***residual claimants***
3. Shareholders are ***Principals*** who hire directors and executives to act as their ***Agents***

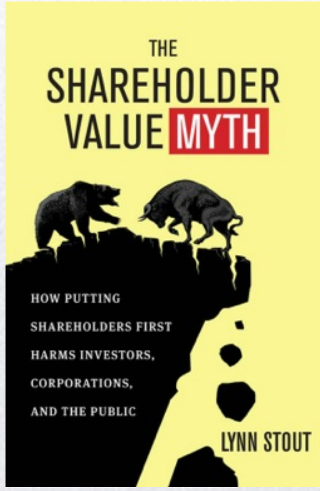


1. **Corporations <u>own themselves</u>** (independent, legal entities)
2. **Shareholders are <u>not the (only) residual claimant</u>** (the Board decides)
3. **Executives own a <u>fiduciary duty to the corporation</u>—not to shareholders** (the board exist prior to the 'principals')

L. Stout (2012)

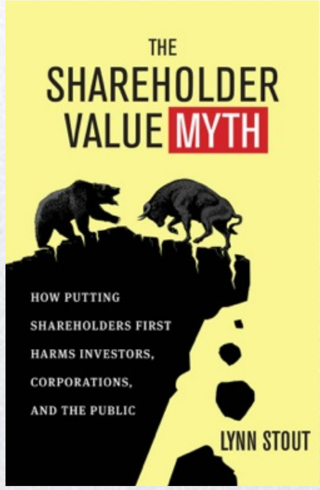
Damaging effects of Shareholder Value thinking

- *“**Shareholder value thinking** causes corporate managers to focus **myopically** on short-term at the expenses of long-term performance; discourages investments and innovation; harms employees, customers, communities; and causes companies to indulge in reckless, sociopathic and socially irresponsible behaviours. **It threatens the welfare** of **consumers, employees, communities and investors alike**”*



The need for a new paradigm

- *Maximizing shareholder value is not a managerial obligation: it is a* ***managerial choice***
- *Corporations are real - the shareholders of the P/A model are* ***fictional*** *(homogeneous, short-termist, self-interested and less prosocial)*
- *Shareholder primacy can* ***hurt shareholders themselves****, both individually in the short-term and collectively in the long-term*
- *Public corporations are more likely to <u>do well</u> for their investors when they <u>do good</u>*



3. Considerations from a Stakeholder Theory perspective

Points in common with ST	Julie Nelson	Lynn Stout
The motivation complexity: Critique of the 'homo economicus" model from both the economist and the corporate law perspective	*"People care. Money is not the only motivation "*	*"Most people are not psychopaths […] Most Shareholders are not psychopaths, either."*
The Separation Fallacy: Both Nelson and Stout see a common problem in today's view of business—what Freeman (1994) calls "the Separation Fallacy"	*"Bringing body and soul together"*	*"Shareholders value different things […]"*
The need of a new narrative: Nelson and Stout agree that the *language* we use matter to shape our understanding *and* our actions—therefore metaphors, beliefs, ideologies, myths can **be useful or harmful…**	*"the 'machine' metaphor has encouraged the development of irresponsible probusiness policies, and impractical antimarket alternatives "*	*"Ideas about corporations matter. […] Shareholder value thinking is based on wishful thinking, not reality[…] We need a new paradigm "*
The need to understand (and measure) **Stakeholder Value**, not just *profit*	*"The central question is not profit itself, but how to measure value"*	*"We don't need a single metric"*

Open questions

- Do you see further common points/implications between Nelson & Stout and Stakeholder Theory?
- What can we do (more) to promote these ideas within Business and Law Schools (to students <u>and</u> educators)?
- How can we stimulate this conversation among Consumers, Investors, Policy makers, Corporate managers, entrepreneurs and Activists??
- When will we not hear anymore something like this…?

"All what I did was in the interest of ENRON's SHAREHOLDERS..."

Thank You.

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